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# Status quo with hawkish undertones

*The RBI delivered no major surprise in the latest monetary policy. Both the repo rate and stance were kept unchanged by a 4-2 vote. However, the statement by the RBI Governor had a marginal hawkish tilt as he underlined the risks that prolonged and elevated food inflation could have on headline inflation. The cautionary tone by the Governor at a time when food inflation continues to register double digit growth coupled with upward revisions to the inflation projections for the next 2 quarters suggest that the possibility of a rate cut now seems most likely only in Dec'24 or even later.*

**Key rates:** With a 4-2 vote, the MPC decided to keep policy rate and stance unchanged. Voting pattern of the MPC signals a growing divergence between members on monetary policy. This is the second straight meeting in which 2 MPC members (Dr. Ashima Goyal and Prof. Jayanth R. Varma) have voted for a rate cut and change in stance. Notably, Prof. Varma has been in favour of a rate cut since Feb'24. This suggests that there are growing calls within the MPC to pivot towards monetary easing. On the other hand, the RBI Governor's statement appeared fairly hawkish with a strong emphasis on elevated food inflation and its impact on headline inflation.

**Growth projections:** The RBI remained positive on the growth outlook and kept its projection for GDP growth unchanged at 7.2% for FY25. However, growth forecast for Q1 FY25 was revised lower by 20bps to 7.1%. *This was on account of lower corporate profitability, muted government capex and lower core output.* In fact, our analysis shows that there has been a substantial moderation in corporate profitability in the last few quarters. *In fact, corporate profit growth has moderated significantly to 0.6% in Q1 FY25 (sample of 1,454 companies) compared with an increase of 47.9% in Q1 FY24, and may see further moderation going ahead.* Even so, we continue to believe that the GDP growth in FY25 will be higher than RBI estimates. Positive impulse for the growth trajectory will come from pickup in private expenditure, normal monsoon and continued uptick in services activity. On consumption, urban consumption is strong, with companies signalling a continued demand in the premium segment. Further, while rural demand is picking up gradually, elevated inflation particularly in food inflation, can derail the recovery.

**Figure 1: Growth projections**

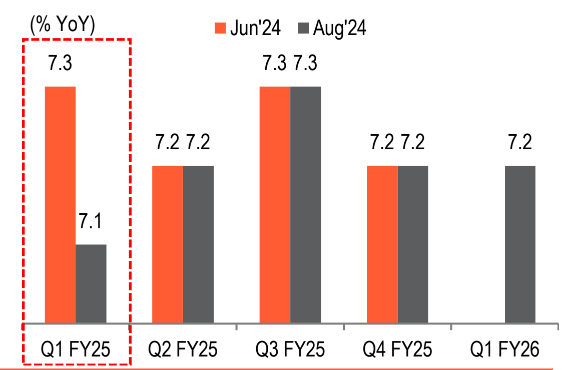
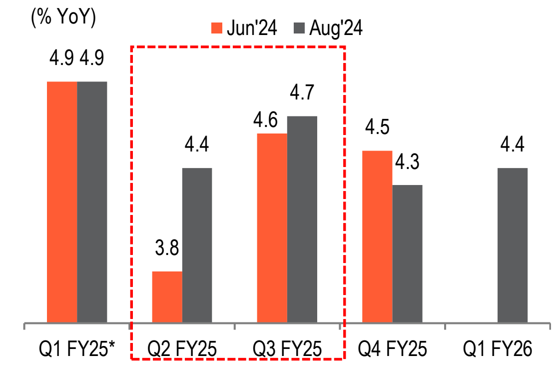



**Figure 2: Inflation projections**




Source: RBI, Bank of Baroda Research

**Inflation projections:** RBI also maintained its FY25 inflation projections unchanged at 4.5%. Interestingly, inflation projection for both Q2 FY25 and Q3 FY25 was revised higher by 60bps and 10bps respectively. On the other hand, inflation in Q4 FY25 is now projected lower at 4.3% (4.5% estimated earlier). The sharp upwards revision to Q2 FY25 inflation projection is significant given the fact that it comes on an elevated base. In Q2 FY24, inflation averaged about 6.4%. This suggests that the RBI does not expect inflation to subside materially in the next few months. The key risk to the inflation trajectory stems from food inflation. This was also outlined in detail in the Governor's statement. Given the high concentration of food items in the consumption basket and the unrelenting upward momentum in food prices recently, the risk of anchoring of consumers' inflation expectations is real. We believe that the same has been reflected in RBI's projections.

**Other announcements:** The RBI Governor also took this opportunity to flag a few issues related to the stability of the financial system. Most of these related to the business operations of SCBs and gave a sense of pre-emptive caution by the RBI. The first issue related to the growing preference by SCBs towards non-deposit instruments to fund the growing credit demand, which can lead to liquidity issues. Instead, the RBI advised the use of innovative instruments or schemes to lure retail depositors. Further, the RBI once again flagged the continued double-digit growth in credit cards outstanding segment, calling for more stringent underwriting and continuous monitoring of such loans. The RBI also identified a sustained increase in top-up housing loans as a possible area of concern, as these loans can be used for unproductive or speculative reasons due to weak regulatory foresight. The RBI also advised banks to strengthen their business continuity plans in view of the recent global outage which caused significant impediments to global businesses.

Apart from these, the RBI also announced a slew of regulatory measures aimed at strengthening the digital payment landscape in the country. These included, enhanced supervision of digital lending apps and increased frequency of submission of credit information by credit information companies (CIC). Both these measures will ensure better credit quality and minimise the risks of NPAs. To further promote UPI payments, RBI increased the limit for tax payments through UPI to Rs 5 lakh from Rs. 1 lakh, and also introduced the concept of "delegated payments" through UPI. The RBI also introduced the continuous clearing system for cheques which will enable faster clearing of cheques and will hence be positive for both retail as well as business customers.

**Market reaction:** Given that the policy decision was in line with market expectations, the movement in key market indices was largely curtailed. There was a marginal increase of 1bps in the benchmark 10Y G-sec yield, as the RBI highlighted risks related to elevated food inflation. In the currency market, INR also declined marginally by ~2 paise even as India's external position is estimated to be robust. Sensex however declined by 0.2%, as the Governor outlined the risks to the banking sector.

**How does RBI fare vis-à-vis other global central banks?** In our view, the RBI has been following a similar approach to other global central banks. The tone and forward guidance of the monetary policy has been controlled and cautious. The Governor spoke about the growing signs of divergence in global monetary policy, a trend which is likely to continue. As global central banks continue their fight against inflation while also balancing growth, the path of the monetary policy will be shaped by countryspecific factors. Even for the RBI, the future course of policy will be driven by the evolving inflation trajectory and unlikely to be determined by the policy decisions of other major central banks.

## Concluding remarks

The RBI policy was on expected lines with both rate and stance being retained. Growth and inflation projections for FY25 were also retained, even as quarterly projections were revised. Importantly, RBI now expects inflation in Q2 FY25 to average 4.4%, significantly higher than its projection of 3.8% earlier. While the moderation in core inflation is a positive, the RBI looks increasingly uncomfortable with the high level of food inflation. Risks stem from anchoring of inflation expectations could spillover to core inflation. Buoyant growth outlook gives RBI to keep rates elevated till such time that it feels that inflation has subsided on a durable basis. Given the outlook on food prices, especially vegetable prices, we do not expect the RBI to cut rates before Dec'24. There is also a very real possibility that the rate cut could be pushed back even further.



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